



For an Equitable Sharing
of National Revenue

POLICY BRIEF 1

**RESPONDING TO SOUTH AFRICA'S
URBAN DEVELOPMENT CHALLENGE**





EXECUTIVE SUMMARY

Urban areas are demographically, economically and politically important, being home to 62% of South Africa's population. While cities may contribute significantly to the economy, they face serious challenges to sustainable and inclusive development. These include high levels of poverty, socio-spatial inequalities, infrastructure deficits, insufficient skills and uneven educational performance. Economic growth, poverty and inequality-reduction objectives will require harnessing the growth potential and other transformational attributes associated with urban areas. The Financial and Fiscal Commission found that certain conceptual, structural and fiscal challenges impede effective urban development spending and programmes.

The Commission emphasises the need for much greater impetus in urban development. This includes investment in housing, more compact cities, transport integration and support for the informal sector; improvements to productivity and industrial diversification; improvements in schooling, particularly its planning in urban areas; and the need for accelerated job creation, especially for young work seekers. There is a need, however, to guard against separating the urbanisation agenda from the overall development agenda, and therefore government should continue making critical investments in non-urban areas.





“ Rapid urbanisation is an ongoing trend shaping national development that will continue in 2018 and beyond. ”

BACKGROUND

Rapid urbanisation is an ongoing trend shaping national development that will continue in 2018 and beyond. The proportion of the total population in urban areas in South Africa was 18.2% in 1911, growing to 56.6% by 2001. In the democratic era, the urban population has increased rapidly from 54% in 1994 to 64.3% in 2014, and is projected to grow to 70% by 2030.

The end of apartheid was 1994 is largely responsible for the ongoing surge in urbanisation. Externally, it signalled the end of the country's isolation from international markets while internally it led to the removal of decades of restrictive apartheid legislation that had artificially held back migration into cities and enforced a high level of circular migration.

Urban economies play a significant role in development and economic growth. While urban areas contribute significantly to the economy, rapid urbanisation and population growth present special challenges to urban development policy. These include high levels of poverty, socio-spatial inequalities, infrastructure deficits, insufficient skills and uneven educational performance. High levels of unemployment remain a top concern. The urban poor are typically located on the urban periphery, living in informal settlements. They face high transport costs and have little access to housing and services.

Compared with similar cities internationally, South African cities use land inefficiently and are less dense. Existing land use patterns marginalise the poor, deepen historic inequalities, and result in high carbon emissions.

City governments are not optimally geared for meeting the challenges. They do not have sufficient funding, particularly for infrastructure investment. Outside the metros urban governments are impeded by a costly two-tier local government system and city governments use obsolete management systems. These suboptimal governance structures and systems exacerbate poverty and inequality, and are costly to society in terms of lost gross domestic product and the further marginalisation of vulnerable population groups.

In this broad context, we seek to explore what national and subnational governments might do to harness the economic possibilities of rapidly expanding cities. To do so, intergovernmental fiscal relations (IGFR) and structures need to be strengthened, and, where antiquated, completely overhauled. This stems from the hypothesis that the current IGFR instruments and institutions for urban development are inadequate and unsuited to meet societal goals relating to economic growth, poverty, unemployment and inequality.



RESEARCH FINDINGS

Stability in the macroeconomic system underpins urban development

Rising income inequality will likely remain a focus in 2018 and beyond given its political and social implications. Together with economic and political changes, ongoing conflicts will continue to exacerbate poverty, unemployment and inequality. It appears unlikely that these scenarios will drastically diminish in 2018, leading up to national elections in 2019. In the interest of budgetary stability, and to address further credit downgrade concerns, simulations show that the country should continue with fiscal consolidation. Relentless negative domestic factors bring substantial uncertainties and downside risks to the economy. This further indicates the need to rebuild the fiscal buffers that helped to moderate the effects of the 2008/09 recession and gave government the necessary fiscal space to act in a countercyclical manner. Successful fiscal consolidation requires deciding which components of the budget will be affected and the pace of fiscal consolidation.

Modelling results also suggest that enhancing rural-urban linkages – through improving policy coordination, undertaking necessary infrastructure investments, strengthening value chains, leveraging intermediate cities, making critical investments in non-urban areas, and promoting productive social protection – can help both rural and urban dwellers.

Complexity of concurrent functions

Schedule 4 of the Constitution assigns different aspects of development as concurrent areas of responsibility to provinces, municipalities and national government. This makes urban development policy complex and transversal, involving different state institutions and agencies. National and provincial governments, urban municipalities, state-owned enterprises and the private sector are all involved in urban development initiatives. Table 1 summarises the urban development mandate and funding of the three spheres of government.

Table 1. Mandate and funding of three spheres of government

Government sphere	Constitutional mandate for urban growth and development	Funding
National	<ul style="list-style-type: none"> Overall coordination of economic development, industrialisation, stabilisation and distribution. Economic development. 	Taxes, borrowing and duties
Provincial	<ul style="list-style-type: none"> Economic: regional planning and development, industrial promotion etc. Social: education, health, social welfare. Oversight over sub-provincial governance structures: municipalities, traditional authorities. 	Own revenue Provincial equitable share Grants (conditional, indirect and other) No borrowing
Local	<ul style="list-style-type: none"> Economic: local planning, infrastructure and services for economic activities: electricity, water, roads, markets, abattoirs, etc. Social: early childhood development. 	Own revenue Local government equitable share Grants (conditional, indirect and other) Borrowing

Source: Commission's compilation.

Within the existing structure, there is no distinct, major body that is responsible for all facets of urban development in the country. While various departments and agencies have certain urban-related functions, these are either limited or applied within the context of specific policies other than urban development. The complexities that result from this concurrency can lead to inertia and duplication of urban development interventions within provinces and across government spheres. A realignment of functions and coordination across various spheres, agencies and departments needs to be proposed.

The challenge of infrastructure and sector coordination

Improved provision of infrastructure would be reflected in a lower cost of service delivery in the medium term, and higher public spending (and related demand for investment goods) in the short term. As an illustration, a R52 billion investment in the transport sector (at 2012 prices) would increase the transport capital stock by 5.6%, once the project is completed, thereby lowering transport costs by 1.8%. Combined demand and supply

effects would increase GDP and exports by 0.4% and 1.3% respectively. The Gini coefficient would decline by 0.3 percentage points under the influence of three factors: higher direct taxes (mostly borne by the richest households) to finance the investment, lower consumer prices for poor households who devote a larger share of their consumption to transport expenditures, and higher demand for informal labour.

Agriculture growth implemented as a complement to urban development is crucial. Agriculture growth has a small effect on national economic performance as its contribution is only 2.5% of total GDP (in 2013). An annual agricultural growth rate of 1.1% on average would positively impact the rest of the economy, i.e. the non-agricultural sector, with one billion additional value added, in constant 2013 Rands. Agricultural growth is pro-rural, as households' final consumption increases more for rural households compared to urban households, primarily driven by the price effect. This strategy may also assist with absorbing some of the excess unemployed labour in the rural sector that would otherwise migrate to urban areas in search of jobs.



CONCLUSION

Enhancing the economic performance of cities now occupies centre stage in policy discourse in South Africa. Within this context, the country aims to achieve faster, more inclusive and sustainable growth. Achieving inclusiveness involves addressing poverty, group equality, regional balance, inequality and empowerment. Urban economies play a significant role in all of this. There is a need to look at how the intergovernmental fiscal relations system can be leveraged to make use of the potential of accelerated urbanisation to drive the positive transformation of the economy to attain rapid economic growth that reduces inequality and eliminates poverty. Thus, urban development is a complex process that requires proper coordination among the departments and role players involved.

There are a number of opportunities:

- Over the medium term, government could continue with a gradual programme of fiscal consolidation that entails reducing the budget deficit moderately, but consistently. Such efforts to preserve fiscal sustainability must be maintained in the future, even with the addition of long-term programmes such as the National Health Insurance.
- Government could actively and specifically

continue pursuing the implementation of significant capital investment in public infrastructure with a positive impact on total factor productivity and employment, in the context of the National Development Plan.

- National government could develop and promote urban-rural relations by:
 - a. strengthening rural-urban linkages and policy co-ordination between rural and urban spaces;
 - b. ensuring rural infrastructure investments are better targeted;
 - c. promoting productive social safety nets; and
 - d. providing incentives to encourage new industries and businesses in rural areas, as a strategy to decongest urban areas.



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